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BANK OF AMERICA

Economic Outlook World 1982

December 1981

Overview

Gradual economic recovery will characterize the world economy in 1982, but certain weaknesses will persist. The governments of the key economies are holding to their anti-inflation, moderate growth policies to avoid another round of high inflation. Consequently, economic expansion will be slow in early 1982; however, real growth will improve after mid-year as inflation abates.

At present, the world economy faces high inflation, low growth, high unemployment, and large imbalances in international payments. Most of these economic difficulties are due to structural changes in global production and trade patterns that reflect the shifts in energy ownership, the effects of technological advances, and the emergence of new competitors in world markets. Also, past overly expansionary policies of many governments have contributed to current economic difficulties. It will take some time for the global economy to overcome these problems.

Still, the world economy will grow to over $12 trillion in 1982, with rates of growth higher in developing countries than in the industrialized nations. The pace of inflation, however, will be substantially slower in the developed nations. World inflation should abate to slightly more than 12 percent in 1982. Slowing rates of growth in the world money supply over the past few years have brought about a downward inflation trend.

World trade, which will exceed $2 trillion, will be more robust than the very poor performance in 1981—even though the rate of growth will be modest by historical standards. Smaller increases in the cost of petroleum will be an important moderating factor. Trade patterns will continue to change in 1982 as more manufactured goods come from the newly industrialized countries and as the developed countries turn more to exports of high-technology goods and exports of services.

FIGURE 1 SELECTED RATES OF REAL ECONOMIC GROWTH 1980-1982

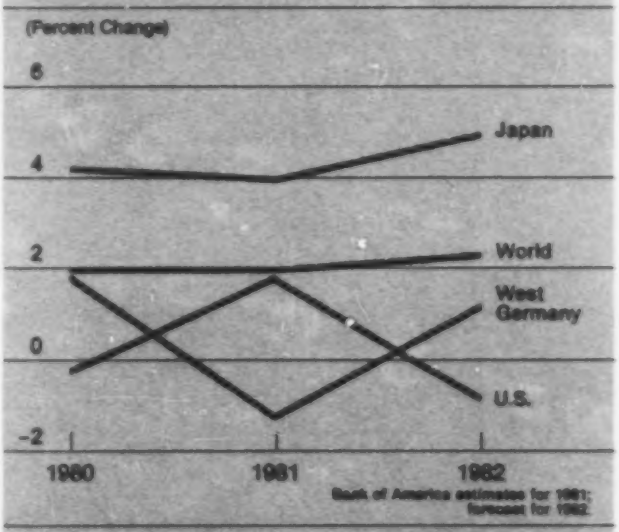
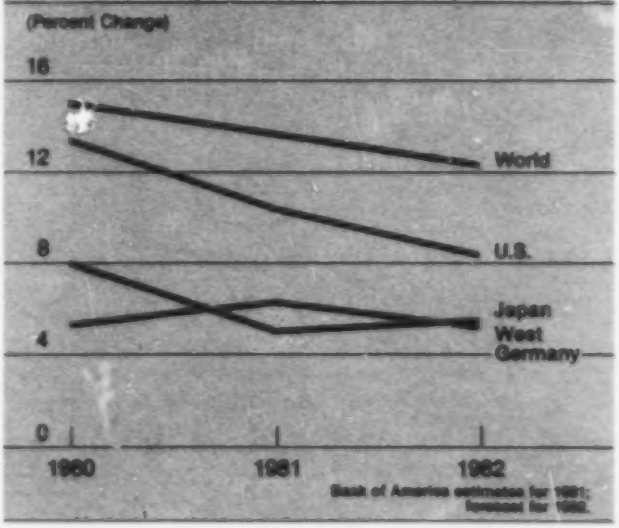


FIGURE 2 SELECTED RATES OF INFLATION 1980-1982



The World Economy

Growth and Inflation—Modest Gains in 1982

In 1982, the world economy will grow by 2.4 percent—somewhat higher than the 2.0 percent estimated for 1981. (See Table 1.) However, the industrial economies of the Organization for Economic Cooperation and Development (OECD) will grow by only 1.6 percent, not much above the 1.4 percent expected for 1981. Growth in the developing countries will again exceed that of the industrial world.

Despite differences among anti-inflation strategies of the major economies, there is a common goal of inflation-free economic growth fed by business investment and rising productivity—leading to falling labor costs with rising employment. Focus on these domestic policies may interfere with the larger goals sought for the world as a whole—better international balances of payments and stability in the foreign exchange markets.

For countries pursuing austere recovery policies, the common risk is that political pressures may mount to implement easier monetary and fiscal policies in the face of slow growth and high unemployment rates. If policies are eased, inflationary pressures may be rekindled even though growth rates in many countries may still remain below potential. Notwithstanding this risk, a reduction in inflation rates worldwide will follow decreases in the rates of monetary growth and real wages that have already been achieved by many countries.

On average, it takes about two years for changes in the money supply to be reflected in inflation rates. (See Figure 3.) The slower rate of growth of the world money supply, dropping from 13 percent in 1978 to 9 percent in 1980, has begun to affect inflation. Global inflation registered 15 percent in 1980 but is expected to ease from the almost 14 percent expected in 1981 to slightly above 12 percent in 1982. Future cooling of inflationary pressures can be expected due to a world money growth rate of less than 10 percent in 1981, with further decreases anticipated for 1982.

Interest rate patterns largely reflect inflation differentials in the various countries. Savers want to be compensated for the expected erosion over time in the purchasing power of their savings, and they demand a premium as an incentive for committing their funds. It is therefore not surprising that interest rates in high-inflation countries, such as France, are substantially above those to be found in low-inflation countries like Japan and Switzerland. (See Table 2.) There is little evidence to support the thesis that high interest rates in the United States pushed interest rates around the world to higher levels. Instead, these rates tend to largely reflect domestic inflation in the respective countries.

Table 1 World Economic Growth Rates 1980–1982

	GDP ($ Billions)	Real GDP (Percent Change)		
	1981	1980	1981	1982
World	$12,160	2.0	2.0	2.4
North America	3,736	0.2	2.2	−0.2
Western Europe	3,577	1.5	0.0	2.0
Eastern Europe	1,262	1.5	1.5	2.5
Middle East	401	0.1	0.6	5.7
Africa	374	5.9	5.7	5.6
Asia	2,215	4.8	4.2	5.1
Latin America	583	5.3	3.9	4.3
OECD Members	8,621	1.3	1.4	1.6
OPEC Members	663	2.9	3.5	6.5
Non-OPEC Developing Countries	1,436	5.8	4.7	5.0
Centrally Planned Economies	1,448	3.2	1.7	2.8

Bank of America estimates for 1981; forecasts for 1982.

International Payments—Better Balance in 1982

The world as a whole will see some reduction in overall imbalances in current accounts in 1982, due primarily to softening of the oil market. Significant reductions in external deficits are being made by the industrial countries, whose collective deficit peaked in 1980 at $70 billion. From an expected $31 billion in 1981, their deficit will drop to $26 billion in 1982.

The OPEC surpluses also will decline, from $98 billion in 1980 and $84 billion expected for 1981 to about $68 billion in 1982. More than 75 percent of the 1982 surplus will be concentrated in Saudi Arabia, Kuwait, and Libya.

While non-OPEC developing countries will face a collective deficit of about $77 billion in 1982, up slightly from $74 billion in 1981, they will receive more adjustment assistance from official agencies in 1982. The International Monetary Fund (IMF) is taking a larger role in the adjustment process in

two ways—by lending more to non-OPEC developing countries and by directly acquiring more funds from surplus OPEC nations. In the centrally planned economies, overall borrowing requirements have been scaled back considerably in the wake of the continued economic problems in Poland and elsewhere.

The increased involvement of the IMF in the balance of payments adjustment process stems directly from the expanded resources that the Fund has at its disposal. The Fund increased its financial resources by 50 percent under its seventh quota review during 1980. These resources are beginning to have a significant impact on world capital flows, particularly with regard to the developing countries. The IMF will not only provide a source of balance of payments finance but will also enhance the adjustment process by encouraging appropriate adjustment policies. By November 1981, some 42 countries had IMF-supported programs, and it is expected that by mid-1982 some 50 to 55 countries will be covered.

The IMF has made a considerable effort to respond to criticism that its financing is too short term to resolve the structural problems facing many of the non-oil developing countries. It now routinely makes loans with maturities of six to seven years. In addition, both the IMF and World Bank are placing increasing emphasis on programs designed to alleviate structural bottlenecks and to take into account the higher energy costs. While the IMF has altered the conditions attached to its funds in certain respects, it is imperative that its conditionality remain sufficiently strong to bring about economic adjustment and that borrowers adhere to their agreements. Otherwise, IMF standby agreements will no longer be respected as the first step toward a country's renewed financial stability.

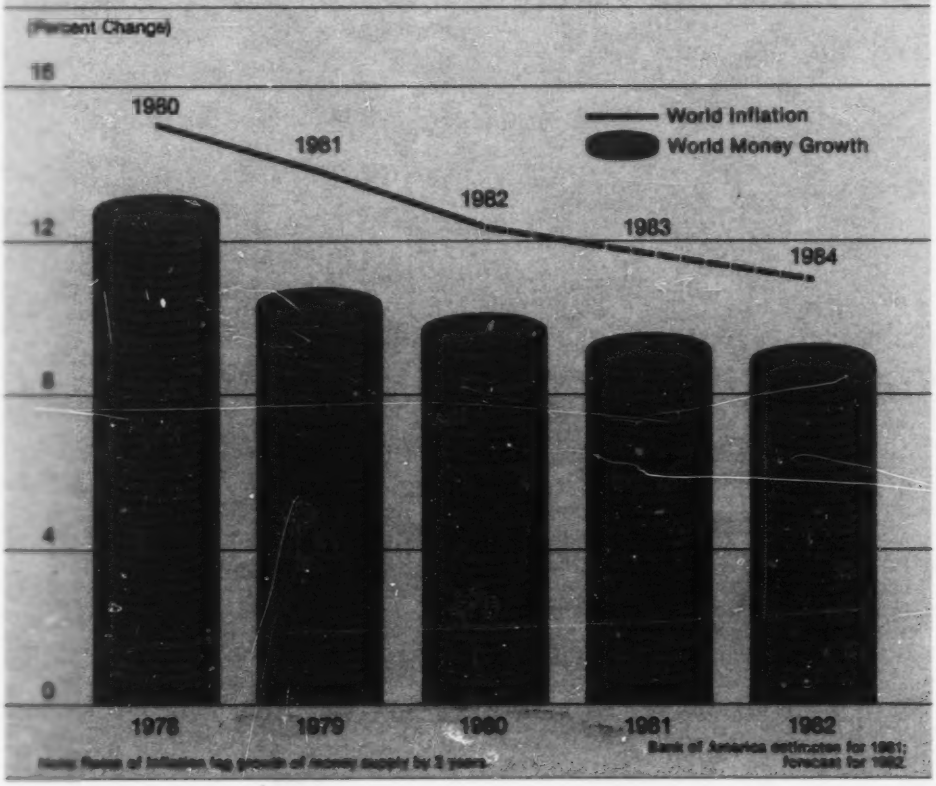
Table 2 Selected Levels of Inflation and Interest Rates—November 1981

	Inflation Rate (Percent)	Interest Rate* (Percent)
France	13.5	15.7
United Kingdom	11.6	14.9
United States	10.4	13.3
West Germany	5.7	11.6
Switzerland	6.5	9.6
Japan	5.0	7.4

*Three-month interbank rate or equivalent.

Slower world money supply growth has brought about a downward trend in global inflation—which should drop to slightly above 12 percent in 1982.

FIGURE 3 WORLD MONEY SUPPLY AND GLOBAL RATES OF INFLATION

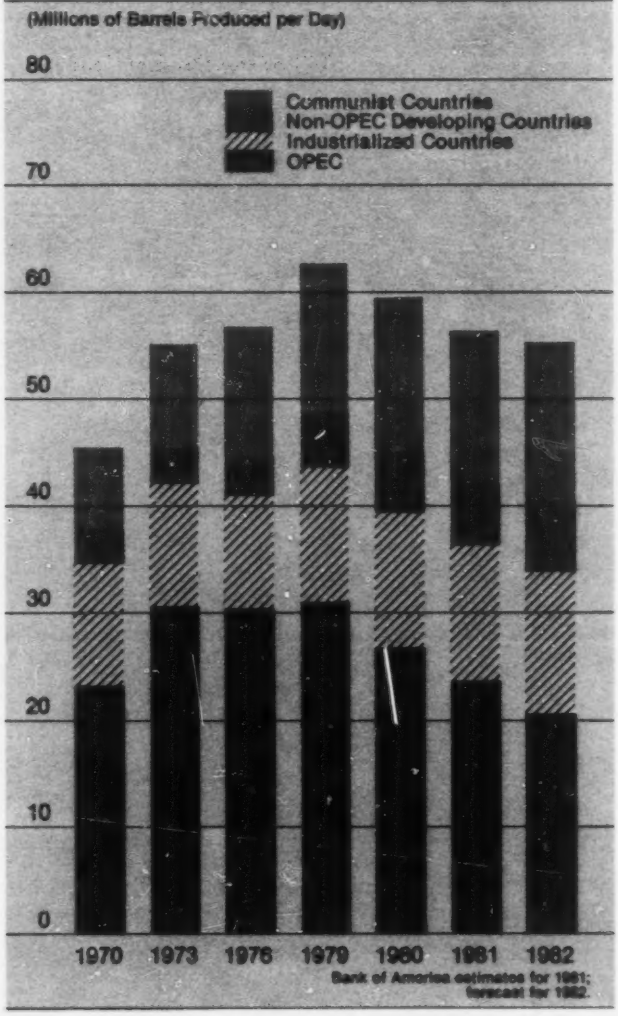


Energy—Only Modest Price Increases

Oil price increases in 1982 are expected to be very modest. The average world price will be $36 per barrel, compared with the 1981 average of $34.50. This implies that inflation-adjusted oil prices will fall in 1982 for the second consecutive year. In response to declines in oil consumption in the industrialized nations, OPEC production has fallen in 1981, and there has been fierce competition by member countries to capture a larger share of the dwindling market.

Producers of higher-priced crude oils lowered their prices sufficiently to permit the adoption of a uniform OPEC pricing scheme. A unified benchmark price of $34 a barrel was agreed upon by OPEC members at their October 1981 meeting in Geneva. The resolution of the pricing disarray prevalent before late 1981 will pave the way for establishing a long-term OPEC pricing strategy for the 1980s—a strategy designed to provide greater price stability and annual price increases of 2 to 3 percent above the rate of world inflation.

FIGURE 4 WORLD OIL PRODUCTION 1970-1982



The resumption of economic growth in the United States and Western Europe in the second half of 1982 will modestly stimulate world oil consumption, reversing the decline of the past two years. World oil consumption will increase 2 percent to approximately 56 million barrels per day. This will be due primarily to a 5 percent increase in usage by the developing countries.

Some non-OPEC developing countries, such as Mexico and Peru, have successfully developed their own energy sources, while others—especially the more advanced countries like Brazil and Korea—have implemented ambitious oil-substitution and conservation efforts. Most developing countries, however, have limited scope for energy saving, if economic progress is not to be unduly delayed. Alternative energy development is costly, and the high energy content of crucial inputs, such as fertilizers, plus the almost exclusive dependence of many countries on overland motor transport also impede energy conservation.

The output of OPEC nations, which peaked in 1973 at 31 million barrels per day, has fallen steadily since the second oil price shock of 1979-1980. (See Figure 4.) Daily production will level off at 20 million barrels by the end of 1981 and probably will remain at this level through 1982. Production by non-OPEC countries—particularly Mexico, Egypt, and the North Sea producers—will continue its upward trend, reaching 20 million barrels per day in 1982. The share of OPEC in free world oil production will thus be reduced to 50 percent. Furthermore, U.S. drilling activity will continue at an extremely high rate, serving to maintain U.S. crude oil production at 8.7 million barrels per day. Barring political upheavals in the Middle East, no major disruption of oil supplies is foreseen in 1982.

World Trade—Some Improvement Expected

World trade growth will be modest in 1982—2.5 percent after adjustment for inflation—but it will be a welcome relief from the negative growth expected for the very depressed 1981 trade year. (See Table 3.)

Two key factors led to the stagnation of world trade in 1981: slow economic growth in Europe and sluggish oil exports. The gradual resumption of higher growth in Europe in 1982 should lead to comparable invigoration of trade there. The impact of the petroleum situation on world trade is more complex. Increasing petroleum prices greatly in-

Real global trade growth will be modest in 1982—an improvement from the low level of 1981—as major structural changes continue in international trade patterns.

Table 3 World Trade Summary

	Exports ($ Billions)		Exports (Percent Change)		Imports ($ Billions)		Imports (Percent Change)	
	1981	1980	1981	1982	1981	1980	1981	1982
World	$2,047	23.2	10.0	14.9	$2,004	21.7	10.3	14.7
North America	342	20.8	13.6	16.4	370	17.5	13.5	16.2
Western Europe	857	18.3	8.0	12.9	895	20.0	6.6	11.9
Eastern Europe	64	24.7	2.4	10.4	79	17.0	6.3	6.7
Middle East	216	41.7	3.8	13.3	119	26.6	21.0	23.3
Africa	128	30.5	13.3	13.7	103	26.8	17.2	15.7
Asia	348	25.4	13.1	20.8	349	27.7	10.5	18.3
Latin America	92	20.8	22.5	13.7	89	27.2	18.9	16.9
OECD Members	1,365	19.3	10.0	14.3	1,414	19.5	8.0	13.1
OPEC Members	316	40.1	6.9	13.2	170	33.8	23.4	23.4
Non-OPEC Developing Countries	291	25.0	15.8	19.8	336	28.0	15.8	17.6
Centrally Planned Economies	75	25.3	1.6	14.5	84	18.1	5.5	11.9

Bank of America estimates for 1981, forecasts for 1982.

flated the value of world trade in the 1970s. More stable petroleum prices are reducing the rate of oil-trade growth in dollar value. At the same time, the resumption of oil exports from Iran and Iraq will add impetus to growth. Also, the recent, relatively modest oil price increases will lead to a renewal of demand for other imports as countries are no longer under extreme pressure to cut back on these imports to pay for oil.

Major structural changes in international trade patterns will occur in 1982. Export market shares will continue to rise for Newly Industrialized Countries (NICs)—including Brazil, Mexico, South Korea, Taiwan, Singapore, and Hong Kong—especially for their manufactured exports. The export mix of the industrial countries will change in response to this competition. The developed countries will concentrate on exporting technologically sophisticated goods (telecommunications and computers) and services (banking and insurance) for which they enjoy a comparative advantage. The NICs will become increasingly competitive in manufactured goods, such as automobiles, steel, appliances, and petrochemicals. The Organization of Petroleum Exporting Countries (OPEC) will continue to place emphasis on the petrochemical industry.

Continuing protectionist pressures in 1982 will pose substantial international problems in four important sectors: textiles and clothing, synthetic fibers, steel, and automobiles. Many capital- and energy-intensive plants in these industries have been made prematurely obsolete by the tremendous energy price increases since 1973. The 1981 U.S.-Japanese agreement for Japan to restrain auto exports highlighted this structural problem. Exporting firms will also increasingly compete against a backdrop of heavy government subsidies as nations attempt to increase jobs through their export industries.

Commodities—Prices Remain Depressed

Prices of most industrial commodities will increase in 1982 at rates lower than the overall inflation rate—due mainly to continued slow growth of the world economy. The modest price increase anticipated for industrial commodities will largely reflect relatively stable production costs. Even though capacity expansion has been rather slow in recent years, levels of production of these commodities continue below capacity. Prices will not start rising until there is sustained growth in the economies of the industrialized countries.

Most agricultural commodity prices will decline in 1982. While prices have historically reflected current production prospects and the size of existing world stocks, they are becoming increasingly sensitive to general economic factors. For example, since high interest rates discourage producers and processors from holding inventories, even the relatively low inventories of some commodities have not kept prices from declining. The expected improvement in the economy in 1982, however, will quickly be reflected in higher prices for these commodities as inventories are replenished.

Record crops in 1981-1982 have eased concerns about short-term global food availability. World grain and oilseed prices have declined considerably, due to abundant harvests of wheat and rice and the recovery of coarse grains and soybean production following 1980's drought-induced shortfall.

As many countries will be replenishing depleted stocks, trade in grains and oilseeds should strengthen. Due to a third consecutive year of poor grain harvest, the Soviet Union is expected to import grain to the extent of its port capacity to maintain its livestock production.

Rising affluence in many middle-income developing countries has fueled a large increase in meat consumption. The resulting shifts in world grain trade, as these countries develop livestock sectors, have been significant and will continue to have a tremendous impact on world markets throughout the 1980s. Previously self-sufficient countries are now importing grains and oilseeds to support their livestock industries, while the traditional importing countries are increasing their consumption. At the same time, the number of grain exporting countries has declined, leading to a critical reliance on the United States as the world's major grain supplier.

For many developing countries, foreign exchange earnings are critically dependent on the export of agricultural and industrial commodities. Low prices have caused balance of payments problems and current account deficits for these countries. No relief will be possible until the world economy improves enough to support higher commodity prices.

Regional Analysis

United States—Weak Recovery in Second Half of 1982

The U.S. recession that began in 1981 will carry into early 1982, with real output declining through at least the first quarter. A turnaround will begin around mid-year, but a still-restrictive monetary policy will keep the recovery weak relative to past upturns. For the year as a whole, real output will decline in a range of zero to 1 percent.

The recession is largely attributable to high interest rates created by restrictive monetary policy. While the Federal Reserve will have some room to ease policy as the economy declines, its determination to lower the rate of inflation by limiting expansion of the monetary aggregates will keep real interest rates at relatively high levels. This implies a weak recovery at best, a prolonged downturn at worst.

The stimulative effect of the Administration's new fiscal package will not appear until the second half of 1982. The 1981 personal tax cuts will do little more than offset the increase in taxes from inflation and the January 1982 increase in Social Security taxes. Incomes will not receive a significant boost until the second stage of the tax cut in July 1982. The resulting weak income growth, when combined with high interest rates, will lead to relatively weak growth of consumer expenditures.

Corporate tax cuts—especially the accelerated depreciation allowances and the increased investment tax credits—will significantly strengthen business fixed-investment incentives over time. But because of the lags in formulating, financing, and implementing investment decisions, the initial effects will be small. Furthermore, the near-term stimulative effects of the tax changes will be overpowered by the negative effects of high interest rates and declining output. As a result, business fixed investment will decline through at least the first half of 1982. Subsequently, investment growth will rise, buoyed by a stronger economy, improved cash flow, lower interest rates, and greater tax incentives.

Declining sales are creating an inventory imbalance, with stocks rising relative to sales. This will require future cutbacks in production. But barring a major collapse of sales, the inventory imbalance is likely to be relatively mild, with inventory levels restored to a normal relationship to sales within one or two quarters. The inventory correction should be completed by mid-1982. The subsequent rebuilding of inventories will provide a positive source of growth.

During 1981, the international value of the dollar rose 25 percent, returning to its 1972 level and reversing nearly a decade of decline. The rebound of the dollar has raised the prices of U.S. export goods and reduced the price of imported goods, creating a deterioration in the balance of payments that will last through the first half of 1982. As interest rates ease downward, capital inflows will weaken and demand for the dollar will decline. In turn, this will strengthen the price competitive-

ness of U.S. goods, setting the stage for greater growth of exports in late 1982 and beyond.

The unwinding of inflation that began in 1981 will continue into 1982, with inflation averaging about 8 percent for the year. Much of the recent decline in inflation reflected the reversal of shock factors—rising energy costs and mortgage rates—that had driven inflation temporarily above its trend rate. These factors will have less effect in 1982, with energy costs rising only moderately and mortgage rates declining. The effects of monetary restraint are just beginning to appear in the underlying or trend inflation rate but will become increasingly apparent in late 1982 and beyond.

Interest rates will gradually trend downward through at least the first half of 1982 but will remain volatile, and the downtrend will be interrupted by sporadic increases. Volatility in rates is virtually assured by the Federal Reserve's continuing emphasis on controlling growth of bank reserves and the money stock. With this policy, changes in the demands for credit and in the money supply create swings in interest rates. The potential for higher rates arises from a possible clash between monetary and fiscal policies. With the federal tax cuts exceeding spending reductions in 1982, the federal deficit and the government's borrowing requirements will remain high through the first half of 1982, rising even higher after mid-year when an additional reduction in personal tax rates takes effect. As the economy picks up, private credit demands will also rise. If monetary policy remains restrictive, the result would be rising total credit demands colliding with a slowly growing money supply—creating another spike in interest rates.

For more details on the U.S. economy, see Bank of America's U.S. Outlook 1982, *obtainable from the source listed on the back cover of this report.*

Canada—Slowed by the U.S. Recession

In 1982, the Canadian economy will weaken again following 1981's recovery. In real terms, GDP is expected to grow only 1.5 percent. The inflation rate will remain in double digits at 11.5 percent due to accelerating labor costs and progressing oil price decontrol.

The Canadian government, determined to reduce its fiscal deficit, has increased taxes somewhat and is holding spending to the rate of real GDP growth. The nation's economic slowdown will be reinforced by its monetary policy, which over the past few years has focused on gradual reduction of the money supply. Interest rates will remain high as the Bank of Canada maintains a positive interest-rate differential—with respect to U.S. interest rates—to support its exchange rate and reduce the movement of capital to the United States.

Consequently, Canada's inflation- and interest-sensitive sectors such as housing, automobiles, and plant and equipment investment will be adversely affected. Exports will decline due to slow growth in the United States. A bright spot for 1982 is the government's decision to—at least temporarily—delay its Canadianization program beyond the energy sector and to soften its anti-foreign-investment posture.

Table 4 Major Economies of North America

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent Change)		
	1981	1980	1981	1982	1980	1981	1982
Region	$3,737.8	0.2	2.2	−0.2	13.8	11.4	9.3
U.S.	3,279.9	−0.2	1.8	−0.9	13.5	10.4	8.2
Canada	282.9	0.1	3.5	1.5	10.1	11.4	11.5
Mexico	175.0	7.5	7.0	6.5	26.3	27.5	24.0

Bank of America estimates for 1981; forecasts for 1982.

Mexico—Energy Driven Boom Continues

Since mid-1978, the Mexican economy has been booming, and this high growth ought to continue through 1982 at a slightly lower rate of 6.5 percent. Mexico's economic surge is based on the rapid expansion of the oil industry, the large inflow of foreign funds, and the conscious effort of the government to accelerate the growth of employment opportunities. Oil development is subject to two different and opposing philosophies. Conservationist groups attempt to utilize oil resources in a long-term development strategy, while other groups press for rapid growth of oil revenues to quickly reduce unemployment levels. The population of 70 million depends on economic progress for the preservation of a stable social environment.

Mexico hopes to create 600,000 new jobs each year, primarily in agriculture and federal work projects. Its greatest need is for skilled labor for industry and commerce. Wages for these workers have increased markedly in 1981 and will probably continue to do so in 1982.

One consequence of rapid economic expansion has been an increase in the rate of inflation. During 1981, Mexico's consumer prices are expected to increase by 24 percent and will continue to grow at that level during 1982. The government has repeatedly emphasized its desire to maintain growth and employment rather than to fight infla-

tion. It has been policy to keep money growth high to assure ample liquidity in the economy.

During the last year, industrial production increased at rates faster than the growth of the entire economy and should continue to do so throughout 1982. The weakest link in the economy has been agriculture. More normal rain patterns and greater investment in irrigation equipment will allow Mexico to come closer to feeding its population in the future, but grain importation will still be necessary. As long as the Mexican population continues to grow rapidly, adequate food supplies will be a major problem.

In response to Mexico's energy bonanza, imports and exports expanded by roughly 200 percent between 1978 and 1981. The oil export sector is influenced by both domestic policy choices and the international petroleum market. If this market performs as expected, Mexican exports will reach $26 billion in 1982, including $21 billion from petroleum exports. Imports should reach $29 billion. Largely due to Mexico's interest payments to other countries, a total current account deficit of $11 billion will have to be financed.

Latin America—Gains in Growth and Inflation

After a period of rapid growth, Latin America will experience average growth rates above 4 percent in 1982. This is a result of deliberate policy measures of many governments designed to slow down their economies while improving their underlying structures, as well as to the general slowdown of world economic activity. Brazil, whose output exceeds 40 percent of the total regional GDP, has purposely followed stabilization measures, which will tend to lower output growth in 1982.

As a by-product of the rapid growth of former years, Latin America has experienced chronic high inflation. Although individual countries such as Chile have attained considerable success in curbing inflation, the two leading countries—Brazil and Argentina—will offset these gains significantly.

Several countries of the Southern Cone have followed free market policies that emphasize the growth of the external sector. Considerable success has been achieved both in the value of exports and in the diversification of the product mix. A trend toward exports of manufacturing is most clear in Brazil, which now derives more than 50 percent of its export earnings from industrial and manufactured goods. It remains, however, the second largest agricultural exporter, following the United States. Argentina and Chile continue to make export gains in agriculture and mining.

In 1982, Latin American exports will reach almost $92 billion, giving the region a small trade surplus. The surplus, however, will be offset by a net outflow in the services account, with much of it due to payments on the large and growing external debt of the region. Its debt, which will reach $193 billion by year-end 1982, will lead to a current account deficit of $25 billion.

Foreign investors have made sizable commitments to Latin America. The region has also increased its participation in international capital markets. Furthermore, its international reserves by year-end 1982 will stand at about $50 billion, with gold valued at market prices. Consequently, the region as a whole is in a fairly strong position to attract needed capital.

Politically, Latin America remains a strong ally to the Western world, and this should continue in 1982. Changes in government leadership will not affect the fundamentally Western orientation. Central America will continue to be a military and ideological battleground in 1982. The Cuban influence is still considerable in Nicaragua and El Salvador, but it has declined in Jamaica.

Table 5 Major Economies of Latin America

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent Change)		
	1981	1980	1981	1982	1980	1981	1982
Region	$592.7	5.3	3.9	4.3	64.9	67.7	58.6
Brazil	250.0	8.6	4.3	4.5	82.8	98.0	85.0
Argentina	94.8	1.1	2.0	3.0	118.0	105.0	85.0
Venezuela	62.4	0.8	3.1	4.0	25.7	22.0	20.0
Chile	26.4	6.5	6.0	5.5	35.1	21.0	18.0

Bank of America estimates for 1981; forecasts for 1982.

Asia—Stronger in 1982

Following two years of sluggish growth, Asia is expected to experience a moderate economic upturn in 1982, reflecting the gradual worldwide economic recovery, another year of modest oil price increases, and falling international interest rates. Real growth in Asia will exceed 5 percent in 1982 due to stronger export demand, a pickup in private investment, and a general easing of restrictive monetary and fiscal policies in the wake of declining inflation.

The Japanese economy will continue on its recovery path in 1982, with real growth reaching 5 percent. While monetary policy may be eased somewhat in early 1982, the ability of fiscal policy

Table 6 Major Economies of Asia

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent Change)		
	1981	1980	1981	1982	1980	1981	1982
Region	$2,214.8	4.8	4.2	5.1	10.1	7.4	7.3
Japan	1,169.0	4.2	4.0	5.0	8.0	5.0	5.5
China	284.0	5.0	3.0	4.5	7.5	5.0	5.0
India	171.2	6.5	3.8	3.9	11.5	10.0	9.0
Australia	163.5	2.8	3.6	4.3	10.2	10.5	11.5
So. Korea	69.2	3.4	5.5	7.0	28.7	24.0	18.0
Philippines	38.2	5.4	5.0	5.5	17.8	9.0	9.0

Bank of America estimates for 1981; forecasts for 1982.

to stimulate the economy is severely limited. A major source of growth will be a recovery in private capital investment. A significant improvement in Japan's current account will result from a combination of sluggish growth in imports and strong growth in exports—although not as robust as in recent years. Its continuing bilateral surpluses with the United States and the European Economic Community will increase trade tensions and probably force Japan to further reduce its nontariff barriers and adopt some temporary measures to increase imports.

In coming years, the center of fastest growth will shift from East Asia to Southeast Asia, which offers good prospects for labor-intensive manufacturing, such as electronics and light machinery, due to its abundant low-cost labor force. The relatively rich energy resources of these countries are also attracting energy-intensive industries like petrochemicals and mineral smelting. In addition, greater processing of indigenous commodities will take place in Southeast Asia. Overall, this region will be less vulnerable to changes in world economic conditions, since the underlying growth trend of demand for its abundant agricultural, mineral, and energy resources will be strong over the long term.

The growth rate of East Asian countries—namely Korea, Hong Kong, and Taiwan—will remain high by world standards but will decline from historical trends because of the need for industrial restructuring in response to increased wages and prices for energy and raw materials. Also, more resources are being allocated to less directly productive social programs. Future growth will be primarily in capital- and technology-intensive industries, which are energy efficient.

Asia's inflation rate will continue to decline in response to the stabilization policies of the past, lower food prices, and higher productivity gains, as well as to the nearly completed adjustment of domestic energy prices to the 1979-1980 oil price hikes. Inflation will increase 7.3 percent in 1982, roughly equal to the 1981 rate. Japan has reduced its inflation rate to 5 percent in 1981, but as the economy strengthens there will be a mild increase in inflationary pressures. Nevertheless, increased productivity, stable unit labor costs, and a gradually strengthening yen will help contain the inflation rate to 5.5 percent for 1982. As the interest rate differential between the United States and Japan continues to narrow, the solid economic fundamentals of the Japanese economy will become increasingly important in determining the trend of the yen.

Despite continued large current account deficits for most Asian countries—Japan being the most notable exception—the region will maintain its comfortable level of international reserves, since the deficit countries are not likely to encounter any difficulty in obtaining balance of payments financing.

Western Europe—Slow Recovery

In the second half of 1982, Western Europe is expected to recover slowly from its 1980-1981 recession. Recovery has been delayed due to the restrictive monetary policies undertaken in 1981 to prevent further deterioration of European exchange rates.

In 1982, economic growth for Western Europe is expected to be about 2 percent, following zero growth in 1981. The impetus for growth will come from increased exports, particularly to the Middle Eastern OPEC countries, and from an increase in domestic demand. In Germany, the increased competitiveness of exports will constitute the main driving force, while in France the government's reflationary policies will contribute to the economy's expansion in early 1982. In the United Kingdom, the rebuilding of inventories and a slight pickup in investment should sustain an upturn after mid-year. Despite slightly improved economic growth in 1982, the overall unemployment rate in Europe will grow, bringing the total number of jobless to 10 million. The increase in the supply of labor is expected to continue to exceed the growth in new employment opportunities.

Inflation in 1982 will slow in most European countries, bringing the overall rate to 10.6 percent. Germany and the United Kingdom will hold to their objectives of lower inflation through monetary restraint by serious efforts to limit the growth in public expenditures and reduced budget deficits. In contrast, France will follow a stimulative policy and try to control inflation with price controls.

Table 7 Major Economies of Western Europe

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent Change)		
	1981	1980	1981	1982	1980	1981	1982
Region	$3,576.9	1.5	0.0	2.0	12.9	12.1	10.6
W. Germany	836.9	1.8	−1.2	1.2	5.5	6.3	5.4
France	756.9	2.0	0.5	2.9	13.6	14.1	14.8
United Kingdom	488.2	−2.8	−1.7	2.0	18.0	11.6	11.1
Italy	366.6	3.6	0.0	2.6	21.3	21.0	16.0
Switzerland	95.7	4.1	0.8	2.2	4.0	6.5	6.9

Bank of America estimates for 1981; forecasts for 1982.

Several other countries—such as Italy and Belgium—will have severe problems in containing their deficits and curbing inflation. Germany, the Netherlands, and Switzerland will continue to exhibit the lowest inflation rates in Europe.

In foreign trade, increased competitiveness of European countries will boost their earnings from exports by 13 percent, against 12 percent growth in their imports. To face the growing challenge from Japan and the newly industrialized nations, European countries are moving to restructure their industries toward internationally competitive activities and encouraging research and knowledge-intensive industries. Europe as a whole is pursuing policies of energy conservation and increased use of coal and nuclear power to reduce the oil bill as well as to decrease dependence on foreign sources of energy. Oil imports have declined in volume as a consequence.

The combined current account deficit is expected to improve slightly, to $26 billion in 1982. Some countries, however, will record a solid improvement in their current accounts due to their successful adjustments to the oil price shocks of 1979-1980. Germany will cut its deficit from $9 billion in 1981 to $4 billion in 1982, while Switzerland and the Netherlands are expected to be in surplus.

There is a growing anxiety about social and military problems in Europe. The future of the European Economic Community (EEC) is a current topic of discussion. France is expected to remain committed to the community and to the North Atlantic Alliance. However, with the stated intention of the opposition Labour Party in Britain to leave the EEC organization, and the similar campaign promise made by the newly elected socialist government in Greece, the future strength of the EEC remains uncertain. In the Scandinavian countries, particularly Sweden and Denmark, a discernible shift to more market-oriented policies is taking place in response to balance of payments problems, high inflation, and growing public indebtedness.

Eastern Europe—Generally Low Growth

The centrally planned economies of Eastern Europe currently face high debt levels, a need to adjust their economies to higher energy costs, declining agricultural productivity, slowing trade with the West, and a growing potential for labor disputes in countries other than Poland.

The Eastern bloc in general has entered into a period of stagnation that will persist at least over the next two to three years. During this period, emphasis will be placed on increasing productivity in the agricultural sector, since potential shortfalls in food supplies are a major factor in political instability. Agricultural exports to the West will be reduced and will not be offset by higher exports of manufactured goods.

Growth rates will be low in 1982 and 1983. The average rate for Eastern Europe is expected to be around 2.5 percent, but large differences among countries exist. Yugoslavia is expected to grow by 3.4 percent, while Poland will continue to stagnate. Slower growth is the result of bureaucratic mismanagement, inefficiency in planning—particularly in manufacturing—and a general lack of incentives for producers. There will be no quick and easy cure for these problems.

Many countries in the Eastern bloc have resisted pricing reforms and sought to keep gas and agricultural prices at very low levels. Rising consumption in the face of decreasing agricultural output has been made possible by heavy reliance on imports for consumption. However, this has meant fewer imports for productive investments.

While inflationary trends are difficult to monitor in state-controlled economies, significant price distortions have begun to appear in most Eastern bloc countries, especially in the energy and agricultural sectors.

Less favorable economic trade relations with the West have pushed Czechoslovakia and Bulgaria closer to the Soviet Union. Hungary and the German Democratic Republic, on the other hand, have diversified their trade relations with the West and

Table 8 Major Economies of Eastern Europe

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent Change)		
	1981	1980	1981	1982	1980	1981	1982
Region	$1,262.0	1.5	1.5	2.5	5.6	8.4	9.5
USSR	718.0	1.8	2.7	2.9	2.0	2.0	2.0
Poland	139.5	−4.0	−9.0	−1.5	8.7	20.0	25.0
Yugoslavia	123.7	3.0	3.2	3.4	29.8	40.0	35.0
E. Germany	86.6	4.2	3.2	3.0	5.0	5.0	5.0

Bank of America estimates for 1981; forecasts for 1982.

have, to some degree, implemented reforms in their domestic price structure. The prospects for these two countries, along with Yugoslavia, appear more favorable in 1982, barring further antagonisms in East-West relations.

In general, the economies of Eastern bloc countries are marked by mismanagement and unfavorable external developments—particularly the poor reception of manufactured exports in Western markets. Except for Hungary, the Eastern European countries also have suffered reduced agricultural output, which raises the potential for more generalized labor problems.

Table 9 Major Economies of the Middle East

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent Change)		
	1981	1980	1981	1982	1980	1981	1982
Region	$401.0	0.1	0.6	5.7	24.8	22.8	18.3
Saudi Arabia	155.0	12.2	8.7	7.3	3.7	8.0	10.0
Iran	80.0	−11.3	−8.7	2.3	50.0	40.0	25.0
Iraq	35.0	−11.0	−25.0	15.0	15.0	15.0	10.0
Israel	18.0	0.5	2.0	3.5	131.0	150.0	120.0

Bank of America estimates for 1981; forecasts for 1982.

Middle East—Much Depends on Oil Demand

Most oil-producing Middle Eastern countries will have declining oil production in the first half of 1982. This will be due to the conservation efforts of the industrialized countries and their slow recovery from the 1979-1980 price shock, as well as to increased production by non-OPEC oil producers. However, by the third quarter of 1982, the recovery in the United States and Europe will help stabilize oil production and may even increase the demand for oil slightly. Oil prices will continue to be soft in 1982. Coupled with sagging production levels, this will lead to a considerable decrease in the growth potential for the oil-producing economies. They should grow by 5.7 percent in 1982, if political turmoil is not increased.

Saudi Arabia will maintain its leadership position in oil production, while Iraq, in spite of its war effort, will push through its ambitious development program. Both countries will be among the fastest growing economies in the region. Iran will continue to be plagued by internal strife, political and administrative chaos, and sagging industrial production, resulting in virtually no growth in 1982.

The inflation rate in some of the oil-producing countries will subside to below 10 percent in 1982. The reduced inflationary pressures will come from an amelioration of supply bottlenecks and a slowdown in the frantic development pace of the late 1970s, as well as from extension of government subsidies for basic commodities and price controls in some countries.

In foreign trade, the Middle Eastern countries will supply a declining share of world demand for oil. Saudi Arabia will adopt a lower production level of 8.5 million barrels a day—down from the 1981 average of 9.5 million barrels—allowing other OPEC members to have a larger share of the export market.

Imports to the region are estimated to grow by 23 percent in 1982. The composition of merchandise imports is expected to alter considerably due to the changing structure and developmental objectives of the Middle Eastern economies. While most countries emphasized infrastructural development in the 1970s, there will be a distinct move toward a more rapid expansion in the supply of services and consumer goods in the 1980s. The import of foodstuffs is expected to grow at a higher rate than machinery and basic manufacturing products, reversing the pattern of the last decade. The United States—with most of its exports to this region now consisting of machinery and manufactured products—will find a new opportunity to expand its food exports.

The current account surplus will drop to $52 billion in 1982 due to continuing soft demand for oil as well as to low production levels in Iran and Iraq. Although Iran and Iraq will increase their production and exports of oil from the very low levels of 1981, the massive imports required to rebuild their war-damaged economies will result in current account deficits for both countries.

Among the non-OPEC nations of the Middle East, Syria and Jordan will expand by 6 to 8 percent. Turkey and Israel will have moderate rates of real growth of 2 to 3.5 percent in 1982. The growth of the Turkish and Israeli economies will be hampered by high inflation, large current account deficits, and high levels of foreign debt. However, the export promotion drive in both countries will be boosted by reduced inflation rates. Pakistan and Jordan will benefit from substantial aid inflow, while Syria will begin to export oil from recently discovered deposits.

The political situation in the Middle East will remain unstable. The Iran-Iraq war may soon wind down, since these countries find themselves deadlocked, with considerable suffering in both human and economic terms. However, the occupation of Afghanistan, the turmoil in Iran, and the uncertainty over the relationships of Israel with its neighbors, along with the rise of religious fundamentalism in the region, will continue to fuel political tensions in the Middle East.

Africa—Mixed Performance in 1982

The performance of the African economies will continue to be mixed in 1982. The oil-exporting countries are expected to achieve positive growth rates but will, with the notable exception of Libya, also have current account deficits. The non-oil-exporting countries will continue to be afflicted by very low rates of economic growth, high rates of inflation, and increasing current account deficits. Economic difficulties will abound in these countries.

Output growth is expected to exceed 5 percent in 1982. The economies of North Africa, Nigeria, Ivory Coast, Cameroon, and Zimbabwe account for more than 60 percent of the continent's GDP. Fueled by their rich natural resources, these nations are projected to achieve growth rates ranging from 5 to 9 percent. However, growth in the other countries will remain generally sluggish, averaging about 3 percent, barely keeping pace with the rate of population increase.

As in previous years, there will be great variation in the experiences of individual countries throughout the continent. The negative effects of droughts and wars in the Sahel area (Chad, Mali, Mauritania, Niger, and Upper Volta) and the East African region will lead to further output declines in 1982.

The rate of inflation is expected to drop somewhat from the 1981 level of 17 percent. Only adherence to IMF stabilization measures by the respective countries will hold down increases in inflation.

The rates of growth in both exports and imports are projected to fall below 1981 rates. Higher prices for minerals—such as copper, lead, and iron ore—are expected to increase the foreign exchange earnings of some economies. But the continued fall of prices for some key agricultural exports as well as the softness in the oil market will offset the revenue increase.

The rise in the aggregate trade deficits of African countries is likely to be accompanied by a continued widening of the deficit in the services account. The combined current account deficit is now estimated to reach $2 billion in 1982. Further, the region's yearly debt service requirements are expected to exceed $2 billion.

Politically, the ongoing conflicts in the Horn of Africa, Chad, and southern Africa will continue to destabilize the continent. The presence of foreign troops will heighten the level of conflict in Africa. Furthermore, Libya's adventurist policy is expected to further weaken the security of the continent—adding a threat of more refugees on a continent that already accounts for five million displaced persons. In contrast, the North African countries—as well as Nigeria, Gabon, Ivory Coast, Kenya, and Malawi—will be politically stable and more able to fulfill their potential over time.

Table 10 Major Economies of Africa

	GDP Level ($ Billions)	Real GDP (Percent Change)			Inflation—CPI (Percent Change)		
	1981	1980	1981	1982	1980	1981	1982
Region	$374.0	5.9	5.7	5.6	17.9	17.2	15.8
Nigeria	70.4	8.0	8.5	9.0	18.0	15.0	13.5
South Africa	60.3	8.0	4.7	3.7	13.7	15.3	11.8
Algeria	50.8	6.5	10.0	9.0	13.6	14.1	13.1
Egypt	30.5	8.0	8.0	7.0	16.5	21.0	20.0
Sub-Sahara Africa*	98.1	0.7	0.3	0.9	21.6	19.0	17.4

*Excludes Nigeria and South Africa.

Bank of America estimates for 1981; forecasts for 1982.

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Bank of America, Box 37000, San Francisco, CA 94137.

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